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August 8, 2007

VIA HAND DELIVERY

REDACTED – FOR PUBLIC INSPECTION

Ms. Marlene Dortch, Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20554

Re: *In the Matter of Special Access Rates for Price Cap Local Exchange Carriers (WC Docket No. 05-25); AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services (RM-10593)*

Dear Ms. Dortch:

Covad Communications Group, NuVox Communications and XO Communications, LLC, through counsel, hereby submit for filing with the Commission their initial Comments in the above-referenced proceedings. The attached document is redacted for public inspection, in accordance the Protective Order in WC Docket No. 05-25. A **CONFIDENTIAL**, unredacted version of the same also has been submitted to the Commission Secretary, and to Ms. Margaret Dailey of the Pricing Policy Division of the Wireline Competition Bureau, under separate cover.

Attached please also find a duplicate of this filing. Please date-stamp the duplicate upon receipt, and return it to the courier. Please feel free to contact the undersigned counsel at (202) 342-8625 if you have any questions, or require further information.

Respectfully submitted,

Brett Heather Freedson

cc: Thomas Navin
Daniel Gonzalez
Ian Dillner
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REDACTED FOR PUBLIC INSPECTION

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Special Access Rates for Price Cap Local Exchange Carriers	)	WC Docket No. 05-25
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	)	
AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services	)	RM-10593
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COMMENTS OF XO COMMUNICATIONS, LLC, COVAD COMMUNICATIONS GROUP, INC. AND NUVOX COMMUNICATIONS

XO COMMUNICATIONS, LLC,
COVAD COMMUNICATIONS GROUP,
INC. AND NUVOX COMMUNICATIONS

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August 8, 2007

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COMMENTS OF XO COMMUNICATIONS, LLC, COVAD COMMUNICATIONS GROUP, INC. AND NUVOX COMMUNICATIONS

XO Communications, LLC ("XO"), Covad Communications Group ("Covad"), and NuVox Communications ("NuVox") (collectively "Joint Commenters") hereby file these comments in response to the Commission's Public Notice asking parties to refresh the record in the above-captioned proceedings.[1]

I. INTRODUCTION AND SUMMARY

Rapidly approaching three years since initiating this proceeding to examine the regulatory framework and rates that apply to price cap local exchange carriers' ("LECs'") special access services and despite overwhelming evidence of market failure, the Commission has yet to take meaningful long-term action to address the Regional Bell Operating Companies' ("RBOCs") and other incumbent local exchange carriers' ("ILECs") detrimental exercise of market power in the markets for special access services. The competition that was predicted and used to justify deregulation has not

[1] *In the Matter of Special Access Rates for Price Cap Local Exchange Carriers*, WC Docket No. 05-25, *AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, RM-10593, Public Notice, FCC 07-123 (July 9, 2007).

materialized. In the absence of competitive or regulatory discipline, ILECs have used and continue to abuse their market power to command unjust and unreasonable rates for special access far in excess of those seen in competitive markets and to impose onerous and anti-competitive limitations in discount plans. Through the continuing use of exorbitant pricing and anti-competitive practices, RBOCs and other ILECs stifle competition and inflict harm on competitors and other consumers of special access services. All this, of course, has a significant detrimental impact on small businesses and consumer welfare. As some already have documented in this proceeding, the dead-weight costs to the national economy resulting from excessive special access pricing alone are staggering.

Since the 2005 filing of initial comments and replies in this proceeding, the evidence of market failure continues to mount with the gap between special access rates (either effectively or in real terms) and costs widening where Phase II pricing flexibility ("PRICE-FLEX") has been granted. As a result, the RBOCs' rates of return on special access services continue to ascend to supra-competitive levels, with two of them near or above a 100% rate of return. For 2006, rates of return for the RBOCs were 132.2% for Qwest, 99.6% for AT&T, and 57.4% for Verizon. Tellingly, the RBOCs continue to criticize these numbers as being "not right" without providing pricing comparisons or rate of return information they claim *is* right. Instead, the RBOCs' rely on inapt average revenue per unit figures, grossly distorted representations of the current state of facilities-based competition, and wildly inflated estimates of competition that may never materialize.

Meanwhile, current comparisons of special access prices to state commission approved cost-based rates for unbundled network elements ("UNEs") show special access

rates significantly above those for corresponding UNEs. *Price comparisons and analysis* conducted by Joint Commenters in these comments provide compelling evidence that the market has failed to work as the Commission had hoped it would. Contrary to the expectation that competition would develop to drive special access rates to competitive levels, under the Commission's PRICE-FLEX regime, special access pricing has moved away from forward-looking costs rather than toward them.

Exacerbating this market failure is the fact that, since the initial comments and replies were filed, the RBOCs have absorbed through mergers the two largest (by far) competitive providers of special access. The only competitive providers with special access market shares that were at or near 10%, AT&T and MCI, are now part of the RBOCs. Further, the ability of remaining competitors to discipline ILEC pricing tactics for metro dedicated transport special access (channel mileage) is exceptionally limited, especially for DS1 circuits. The ability of competitors to discipline ILEC pricing tactics in the markets for various special access channel terminations is virtually nonexistent. Indeed, competitive local exchange carriers ("CLECs") are unable economically to self-supply or to obtain competitively provisioned alternatives to sub-OCn-level ILEC special access circuits.

Other recent regulatory developments have further increased the ILECs' market power in the provision of special access services. For instance, during the past two years, state commission implementation of the Commission's *Triennial Review ("TRO")* and *Triennial Review Remand Orders ("TRRO")* has resulted in significant limitations on CLECs' access to UNEs priced at forward-looking costs. Lacking virtually any competitive alternatives, competitors have had to convert nearly every high-capacity UNE loop (DS1 and above) lost to a non-impairment decision to unreasonably priced

ILEC-provided special access, much to the detriment of their customers and their businesses.

The manner in which Section 271 of the Act has been implemented in many states also serves to increase the market power of ILEC special access providers. In most states, ILECs have prevailed in largely equating Section 271 loop and transport checklist items with special access thus rendering Congress's enactment of the checklist a nullity. Only a few states have acted to give Section 271 teeth by ensuring that checklist items are priced at just and reasonable rates and then, the RBOCs immediately sought to reverse those decisions. Several of these states have been reversed in federal court and the others remain embroiled in litigation. One state, Georgia, requested guidance from the Commission on these matters. The Commission has not responded and its inaction continues to fuel the very regulatory uncertainty it repeatedly has acknowledged undermines the development of competitive markets. This inaction also fuels the growth of RBOC market power in the special access markets.

Notably, the market failure that has resulted in part from the Commission's decision to deregulate special access by granting pricing flexibility based on predicted competition rather than actual or effective competition recently was observed in a November 2006 study and report by the Government Accountability Office ("GAO").[2] In its report to the House Committee on Government Reform, the GAO determined that the Commission's pricing flexibility orders have resulted in increasing prices (in a declining cost industry) characterized by scant to non-existent competitive supply. The

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[2] *FCC Needs to Improve Its Ability to Monitor and Determine the Extent of Competition in Dedicated Access Services*, United States Government Accounting Office, Report to the Chairman, Committee on Government Reform, House of Representatives, GAO-07-80 (released Nov 2006) ("*GAO Report*").

GAO recommended that the Commission take action to better define effective *competition and to consider additional data to measure competition. The Commission's* unconvincing response to the report is that the costs of regulating special access are greater than those associated with the current PRICE-FLEX regime and that measuring actual competition somehow would be impractical or infeasible.

Today, all evidence points to the fact that the Commission must remedy its unrealized prediction of competition and premature deregulation of special access by eliminating Phase II pricing flexibility and by reinitializing special access rates. While re-initialization at forward-looking costs that approximate the pricing that would occur in a competitive market is one desirable solution, it may be more expedient, at least on an interim basis, to reinitialize special access pricing through the restoration of price caps based on an 11.25% rate of return. The Commission also should restore the X-factor, using 5.3% as the X-factor on an interim basis subject to further consideration. Immediate price relief is not the only relief that is essential to meaningful special access reform. The Commission also must act to proscribe exclusionary pricing practices and other anti-competitive terms and conditions in special access agreements, as such practices and terms deter facilities-based competition and diminish consumer welfare.

II. BACKGROUND

The Commission established price cap regulation of special access rates in 1991 to allow LECs to recover their costs and a reasonable profit while, at the same time, curbing the perverse incentives of more traditional rate-of-return regulation.[3] Rather than

[3] *Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, Second Report and Order, 5 FCC Rcd 6786, 6818-20, ¶¶ 257-59 (1990)

limiting the profits a carrier might gain as rate-of-return regulation did, price cap regulation focused on the prices charged and resultant revenue earned from special access services, giving price cap LECs the incentive to reduce costs and increase efficiency in order to increase profits.[4] The initial price cap rates were set at levels existing when rate caps were imposed and then were adjusted annually based on a productivity factor (the "X-factor").

Additionally, two mechanisms allowed price cap LECs to establish rates above price cap levels. First, a low-end adjustment mechanism, whereby price cap indices were adjusted upward, was permitted if the LEC earned returns below a specified level in a given year.[5] Second, price cap LECs were allowed to set rates above the price cap levels if those rates would result in low earnings deemed to be confiscatory.[6] Thus, remedies were and continue to be available for an ILEC that believes its price cap regulated rates are too low. Furthermore, the Commission anticipated that competition would eventually eliminate the need for any rate regulation and "reserved the right to adjust rates in the future ***to bring them in line with forward-looking costs***."[7]

At the behest of the price cap LECs, the Commission adopted the *Pricing Flexibility Order* in 1999, where the Commission made predictions about the existence of

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("*LEC Price Cap Order*"), *aff'd Nat'l Rural Telecom Ass'n v. FCC*, 988 F.2d 174 (D.C. Cir. 1993).

4 Special Access Rates for Price Cap Local Exchange Carriers; AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services, *Order and Notice of Proposed Rulemaking*, WC Docket No. 05-25, ¶ 11 (Jan. 31, 2005) ("*Special Access NPRM*").

5 *Special Access NPRM* ¶ 12.

6 *Id.*

7 *Id.* ¶ 13 (emphasis added).

growing competition in certain metropolitan statistical areas ("MSAs") and allowed ILECs to offer special access services in those MSAs at unregulated rates via contract tariffs.[8] Specifically, the Commission predicted that the extent of collocation by competitors ("collocation trigger") would indicate the existence of irreversible competition which would discipline rates.[9] Under Phase I relief, a LEC may offer volume and term discounts and enter into contract tariffs, but it must continue to make generally available to all customers its regulated price cap tariff rates.[10] Under Phase II relief, a LEC is not required to conform to the regulated price cap rates.[11] According to

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8 *Access Charge Reform*, CC Docket Nos. 96-262, 94-1, 98-63, 98-157, Fifth Report and Order and Further Notice of Proposed Rulemaking, 14 FCC Rcd 14221, 14224-25, 14232-33, 14234-35, 14257-310, ¶¶ 77-83 (1999) ("*Pricing Flexibility Order*"), *aff'd WorldCom v. FCC*, 238 F.3d 449 (D.C. Cir. 2001).

9 *Special Access NPRM* ¶ 18; *Pricing Flexibility Order* ¶ 144. As demonstrated throughout these comments, the Commission's predictive judgment has proven to be in error. The Commission's decision also is flawed because it does not even permit the reversal of a pricing flexibility determination if the triggers are no longer met.

10 *Special Access NPRM* ¶ 17. To obtain Phase I pricing flexibility for interstate special access services other than channel terminations between a LEC end office and an end user's customer premises, a price cap LEC must demonstrate that unaffiliated competitors have collocated in at least 15% of the LEC's wire centers within an MSA or collocated in wire centers accounting for 30% of the LEC's revenues from these services within the MSA. To obtain Phase I pricing flexibility for channel terminations between a LEC end office and a customer premises, the LEC must demonstrate that unaffiliated competitors have collocated in at least 50 percent of the LEC's wire centers within an MSA or collocated in wire centers accounting for 65% of the LEC's revenues from these services within the MSA. 47 C.F.R. §§ 69.709, 69.711; *Pricing Flexibility Order*, 14 FCC Rcd at 14235-36, 14273-77, ¶¶ 24, 93-99.

11 *Special Access NPRM* ¶ 17. To obtain Phase II pricing flexibility for special access services other than channel terminations to end users, the trigger thresholds are unaffiliated collocation in 50% of the LEC's wire centers or in wire centers accounting for 65% of the LEC's revenues from these services within the MSA. For channel terminations to end users, the Phase II thresholds are unaffiliated collocation in 65% of the LEC's wire centers or in wire centers accounting for 85% of the LEC's revenues for these services. 47 C.F.R. §§ 69.709, 69.711; *Pricing Flexibility Order*, 14 FCC Rcd at 14235, 14298-300, ¶¶ 25, 146-52.

the GAO, "[s]ome level of pricing flexibility has since been granted to the four major price-cap incumbents in 215 of the 369 MSAs in the United States and Puerto Rico. These four price-cap incumbents have received full price deregulation (phase II for all circuit components) in 112 MSAs. Only 3 of the 100 largest MSAs [San Juan-Bayamon, Puerto Rico; Youngstown-Warren, Ohio; and Sarasota-Bradenton, Florida] in the United States and Puerto Rico are not under any pricing flexibility."[12]

In 2000, the Commission adopted the CALLS plan, which was intended to be a five-year interim regime to eliminate implicit subsidies in access charge rates and move toward a market-based approach to rate setting.[13] The Commission hoped that, by the end of 2005, sufficient competition would exist to discipline rates so that rate regulation would no longer be necessary. However, as the Commission recognized in the *Special Access NPRM,* such competition had in fact not developed by 2005 and thus the Commission decided to maintain the CALLS regime until conclusion of the instant proceeding.[14] Such competition still has not materialized.

The Commission, at the time, acknowledged that its regulatory regime might grant pricing flexibility before competition was substantial enough to actually discipline special access rates. It accepted that probability, however, because it deemed the costs of

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12 *GAO Report* at 6.

13 *Access Charge Reform*, CC Docket Nos. 96-262, 94-1, 99-249, 96-45, Sixth Report and Order in CC Docket Nos. 96-262 and 94-1, Report and Order in CC Docket No. 99-249, Eleventh Report and Order in CC Docket No. 96-45, 15 FCC Rcd 12962 (2000) (*CALLS Order*), *aff'd in part, rev'd in part, and remanded in part, Texas Office of Public Util. Counsel v. FCC*, 265 F.3d 313 (5th Cir. 2001), *cert. denied, Nat'l Ass'n of State Util. Consumer Advocates v. FCC*, 535 U.S. 986 (2002), *on remand, Access Charge Reform*, CC Docket Nos. 96-262, 94-1, 99-249, 96-45, Order on Remand, 18 FCC Rcd 14976 (2003).

14 *Special Access NPRM* ¶ 2.

continuing regulation higher than the risk of granting premature relief.[15] Believing that the ILECs could not exercise market power where they faced competition from entrants using their own facilities,[16] the Commission down-played evidence that the ILECs possessed high market shares for special access services despite the entrance of some competitive providers. Therefore, the Commission assumed that satisfaction of the collocation triggers it established would ensure adequate competition to prevent ILECs from charging unreasonable rates to customers with no competitive alternatives, from deterring market entry, or from engaging in exclusionary pricing behavior.

Almost before the ink was dry on the first orders granting Phase II pricing flexibility, ILECs began responding to that supposed price-constraining competition by raising their prices, not lowering them. As has been well documented in the record, the resulting harms to facilities-based competitors, small businesses, and consumers have been enormous.[17]

In late 2002, the legacy competitive provider AT&T filed a petition for rulemaking highlighting this market failure and requesting that the Commission essentially revoke its pricing flexibility rules and revisit the ILEC price cap rates established under the CALLS plan.[18] The Commission sought comment on that petition but did not act on it. In 2003, AT&T filed a petition for mandamus with the D.C. Circuit

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15 *Pricing Flexibility Order* ¶ 144.

16 *Pricing Flexibility Order* ¶¶ 69, 84-86.

17 *See, e.g.,* Ad Hoc Telecommunications Users Committee Comments, WC Docket No. 05-25, at 5 (June 13, 2005); Nextel Comments, WC Docket No. 05-25, at 9-12 (June 13, 2005).

18 *AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, RM-10593, Petition for Rulemaking at 6-7, 35-36 (filed Oct. 15, 2002) ("*AT&T Petition for Rulemaking*").

Court of Appeals, requesting the court to direct the Commission to take action. The mandamus petition effectively was mooted when the Commission adopted its *Special Access NPRM* in January 2005 to address the open issues raised in the *AT&T Petition for Rulemaking*.

Evidence presented by competitors in these proceedings demonstrates that the Commission was in error in granting Phase II pricing flexibility to the ILECs based upon predicted rather than actual competition. Furthermore, the findings released by the GAO in November 2006 are consistent with that evidence and clearly show that these non-competitive conditions and supra-competitive special access rates still exist today. Despite abundant evidence of market failure, the Commission has allowed far too much time to pass without correcting the competitive imbalance in the special access market.

On May 23, 2007, Rep. Edward J. Markey, Chairman of the House Subcommittee on Telecommunications and the Internet, expressed his concern that "significant concentration in the special access market through mergers and bankruptcies, combined with the Commission's deregulatory pricing regime, has resulted in higher prices and little competitive choice for special access connections."[19] Highlighting the GAO's findings, as well as the data in this record and in the recent merger proceedings, Chairman Markey urged the Commission to address these concerns by modifying its pricing flexibility rules so that special access rates will reflect those in a truly competitive marketplace.[20]

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19 Letter from Edward J. Markey, Chairman of the House Subcommittee on Telecommunications and the Internet, to the FCC, at 2 (dated May 23, 2007) ("*Markey Letter*").

20 *Id.* at 2.

In response to Chairman Markey's letter, the Commission issued a Public Notice requesting interested parties to refresh the record. *Joint Commenters welcome the* Commission's request to refresh the record in the instant proceeding. The Commission can no longer disregard the dearth of competition and the plight of captive carriers and consumers in special access markets. This Commission should insist that price constraining competition occurs before the deregulation of rates. Furthermore, because even the regulated price cap rates are excessively higher than cost, the Commission should reset price cap rates at a "just and reasonable" level, which can be done by reinitializing the price caps with an 11.25% rate of return and by reinstating the X factor at 5.3%.

III. EVIDENCE OF MARKET FAILURE IS UNDENIABLE

A company with market power is able, among other things, to impose substantial above-cost price increases over a sustained period without losing significant demand from its customers. The Commission itself has noted that "a substantial price increase need not be a large one;"[21] therefore, even a small increase in special access rates may indicate an abuse of market power. In this case, however, special access rates have increased dramatically since the Commission adopted its pricing flexibility rules. For example, T-Mobile reports that Qwest's special access rates increased 62% between 2002 and 2005 in areas that have been granted pricing flexibility, AT&T (legacy SBC) rates in PRICE-FLEX areas increased 27% between 2002 and 2005, and AT&T (legacy PacBell) rates in PRICE-FLEX areas increased 15% between 2002 and 2005.[22] As the greatly inflated returns indicate, the PRICE-FLEX regime has produced rates well in excess of

21 *Special Access NPRM* ¶ 74 & n.188.

22 Attachment 1, T-Mobile Presentation to NARUC at 6.

costs contrary to what is expected in competitive markets. And given that "[m]ore than half of the Bells' special access revenues come from areas where they are no longer subject to price cap regulation,"[23] this is no small concern. Because they lack competitive alternatives in most areas (despite supposedly having sufficient competition to justify pricing flexibility), special access customers competing with their ILEC suppliers must absorb these higher rates or stop serving their own retail customers. The RBOCs' special access customers must naturally pass on these rate increases to their own customers; therefore, "[b]y charging other carriers these inflated rates, the Bells also avoid retail price competition."[24]

A. Substantial and Sustained Above-Cost Rate Increases in MSAs Where ILECs Have Been Granted Phase II Pricing Flexibility and Soaring Rates of Return Provide Undeniable Evidence of Market Failure

As a direct result (and *prima facie* evidence) of rates far exceeding costs, the RBOCs' interstate special access rates of returns have skyrocketed in the years since pricing flexibility was permitted. AT&T's (based on combined legacy SBC and BellSouth data) rate of return increased from 40% in 2000 to 100% in 2006, Verizon's increased from 15% in 2000 to 52% in 2006, and Qwest's increased from 38% in 2000 to 132% in 2006.[25] The RBOCs have sought to counter these outrageous returns by nitpicking at the underlying, ARMIS-derived, data; however, there is no way to explain away the fact that these returns are well in excess of the Commission's initially prescribed rate of return of 11.25%. In fact, the Joint Commenters are unaware of any

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23 *AT&T Petition for Rulemaking* at 2-3.

24 *AT&T Petition for Rulemaking* at 4.

25 FCC Report 43-01, Table I Cost and Revenue, Column(s) Special Access, Row 1915 Net Return divided by Row 1910 Average Net Investment.

RBOC statement claiming their returns even approach this level. Simply put, claims of ARMIS data discrepancies and past under-earning cannot explain away or justify these outrageous rates of return.

The RBOCs also have argued that the increase in their special access revenues since gaining pricing flexibility in certain MSAs is due to growth in demand rather than increased and supra-competitive rates. To support their claims against reliance on the ARMIS-derived rates of return, the RBOCs try to convince the Commission that their special access revenue per line is the most relevant statistic to consider. They argue that the average revenue per line should be considered a proxy for special access rates and that the declining trend in their private calculation of those revenues indicates that special access rates also have been declining.[26] One must wonder why the RBOCs need to develop a proxy for special access prices when they have their actual pricing data at their fingertips. The reason why they hide behind a contrived annual revenue proxy is because their actual tariffed rates are so glaringly supra-competitive and the returns they produce are not those that could be expected in a competitive market.

As thoroughly discussed by Dr. Joseph Farrell, the former Chief Economist of the Commission, in his declaration already on the record, the RBOCs' assertion of the validity and significance of their special access revenue per line statistics is based on unsubstantiated data and erroneous assumptions.[27] Dr. Farrell explained that the RBOCs'

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26 *Special Access Rates for Price Cap Local Exchange Carriers*, WC Docket No. 05-25, *Comments of Verizon, Declaration of William E. Taylor on Behalf of Verizon*, at 5, n.7 (filed June 13, 2005) ("*Taylor Decl.*").

27 *Special Access Rates for Price Cap Local Exchange Carriers*, WC Docket No. 05-25, *Reply Comments of CompTel Global Crossing North America, Inc. and NuVox Communications, Reply Declaration of Joseph Farrell On Behalf of CompTel*, at 9-20 (filed July 29, 2005) ("*Farrell Decl.*").

conclusion that revenue per line has decreased cannot be verified because of the many assumptions and adjustments made by their economist, Dr. Taylor, in developing the revenue data.[28] Furthermore, Dr. Farrell explains that even without any price reduction, manipulation of the ARMIS access line count can show a decrease in revenue per line, based on how the number of utilized special access lines is captured in the ARMIS data.[29] Thus, average revenue per special access line does not reveal anything concrete about the RBOCs' special access prices. Furthermore, the competitor analyses of increases in actual RBOC tariffed rates from 2000-2005 belie the RBOCs' claims of reduced rates.

Finally, and critically, Dr. Farrell makes the fundamental point that even if the trend in RBOC special access rates was falling, this would not confirm a lack of market power because "[e]ven a monopoly will reduce price if marginal costs fall or if demand becomes more elastic."[30] He concludes by confirming that the relevant consideration for the Commission is not the rate of increasing (or even decreasing) rates, but rather the relative levels of price and cost,[31] underscoring the need for the comparison and analysis of RBOC special access rates and cost-based UNEs rates that Joint Commenters have undertaken below.

The Commission adopted Phase II pricing flexibility with the expectation that significant competitive forces would prevent an ILEC from exerting such market power. Industry data and experience have proven the opposite: that inadequate competitive forces have permitted ILECs to raise their prices to supra-competitive levels. As the

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28 *Farrell Decl.* at 10-11.

29 *Id.* at 11-13.

30 *Id.* at 16.

31 *Id.* at 16, 18.

GAO Report highlights[32] and as supported by competitor data analysis, the large price cap LECs consistently have increased their special access PRICE-FLEX rates well above costs. Notably, after a review of actual RBOC rates, not proxies, the GAO found that list prices and average revenues in Phase II MSAs tend to be higher than or the same as list prices and average revenues in areas still under some Commission price regulation.[33] Indeed, the GAO's analysis of 1,152 list prices and other data "generally shows that prices and average revenues are higher, on average, in phase II MSAs—where competition is theoretically more vigorous—than they are in phase I MSAs or in areas where prices are still constrained by the price cap." The GAO explained:[34]

> Since phase II pricing flexibility was first granted, list prices for dedicated access that apply under phase II, on average, have increased. Conversely, price-cap list prices available in phase I and price-cap areas were pushed downward over the same period—largely by the CALLS order. As a result, average list prices in areas with phase II flexibility are higher than average list prices in phase I and price-cap areas.[35]

Despite the existence of discount plans for customers that may enter into special contracts with the ILECs, as explained further below, the necessary volume and term commitments for carriers to obtain those discounts are often too onerous. Thus, while those discounts and lower rates may be available to some special access customers, they are not by any means universally available to all customers. Furthermore, while there may have been reasons, as the Commission has indicated, for ILECs to raise some price cap rates that

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32 *GAO Report* at 1.

33 *Id.*.

34 *Id.* at 13.

35 *Id.* at 13.

may have been below cost, there can be no valid justification for the consistently higher rates found in Phase II MSAs than in Phase I MSAs.

A recent Progress & Freedom Foundation ("PFF") Report on special access attempts to undermine the GAO findings by asserting, although without "definitive conclusions," that pricing flexibility itself may have led to increased ILEC investment (using quantity of lines sold as a proxy for investment),[36] suggesting that the increase in ILEC output indicates no abuse of market power. This study, as its author admits, "is incomplete because it has ***no information on prices.***"[37] Its results are thus fundamentally suspect.

B. Comparisons of Special Access Prices to Forward Looking Cost-Based UNE Rates for Comparable Services Provide Compelling Evidence That, with Few Exceptions, Special Access Rates in Most Instances Are Not Just and Reasonable

The Commission has stated its preference for special access rates to move toward a cost-based rates. In the *Access Charge Reform Order* the Commission put the ILECs on notice that "[t]o the extent that competition did not fully achieve the goal of moving access rates toward costs, the Commission reserved the right to adjust rates in the future to bring them into line with forward-looking costs."[38] The best estimates of the ILECs' forward-looking costs of providing special access services are naturally the cost-based UNE rates for comparable services.[39] To provide updated pricing information for the Commission, Joint Commenters have compiled and analyzed a sampling of RBOC rates,

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36 Scott Wallsten, *Has Deregulation Affected Investment in Special Access?*, at 10 (released by the Progress & Freedom, July 2007) ("*PFF Report*").

37 *Id.* at 11 (emphasis added).

38 *Access Charge Reform* CC Docket No. 91-212, First Report & Order, 12 FCC Rcd at 15982, 16002-03, ¶ 47.

39 *See Farrell Decl.* at 18-20.

which demonstrate that the rates for special access channel terminations and mileage are, *with rare exception, significantly higher than for comparable TELRIC-based UNE rates.* These comparisons ultimately indicate that special access rates are excessively above cost and are therefore unjust and unreasonable.

Joint Commenters selected several states served by each RBOC and focused analysis on the highest density zone in each of those states, where costs should be the lowest in the state and the level of competition (at least theoretically) the highest.[40] These comparisons show that special access rates are substantially above forward-looking costs (with few exceptions). This disparity in pricing, especially in these high density study areas, constitutes anti-competitive behavior and the abuse of market power.

In all the states analyzed, the month-to-month recurring price cap recurring rates (no term commitment) for DS1 loops/channel terminations are vastly higher than the UNE DS1 loop rates, ranging from 67% higher in Arizona to 802% higher in Illinois.[41] The month-to-month recurring Phase II pricing flexibility rates are all at least 100% higher than the UNE DS1 loop rates, with many of the state Phase II rates 200-300% higher than the cost-based UNE rates.[42] Significantly, in all but one state surveyed, the Phase II pricing flexibility rates were also higher than the regulated price cap rates in the highest density zone in the state.[43]

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40 *See* Attachment 2. Joint Commenters compared and analyzed RBOC special access and UNE pricing data from the following states: Arizona, California, Colorado, Georgia, Illinois, New York, Pennsylvania, Texas, and Virginia.

41 Attachment 2, *Comparison Of UNE DS1 Loop And Special Access Rates, For Qwest in Arizona & For AT&T in Illinois.*

42 Attachment 2, *Comparison Of UNE DS1 Loop And Special Access Rates* (for all states).

43 Attachment 2 , *Comparison Of UNE DS1 Loop And Special Access Rates (for all states).* In accordance with the conditions of its merger with BellSouth, AT&T

In a competitive environment, one would expect that special access rates would tend to be closer to cost-based rates as customers are required to commit to longer terms of service. The data, however, does not bear that expectation out. Where the surveyed carriers offer a 1-year term commitment special access contract, both the price cap rates and the Phase II rates for DS1 channel terminations are still considerably higher than the UNE DS1 loop rates, with the price cap rates ranging from 62% higher in Arizona to 585% higher in Illinois and the Price-Flex II rates ranging from 131-607% higher.

Even 3-year special access term plans do not significantly reduce the disparity between the UNE loop rates and either the price cap rates or Phase II rates for ILEC special access channel terminations. Under available 3-year plans, price cap rates are still 52-268% higher and Phase II rates are 75-272% higher than the cost-based UNE rates.[44]

The non-recurring charges ("NRCs") for special access channel terminations also are exorbitantly higher than those charges for UNE DS1 loops, with charges in Texas, Pennsylvania, and Virginia all being over 1,000% higher than the non-recurring charge permitted for UNE services.[45] Verizon does not offer a 1-year term commitment plan and its special access NRCs in Pennsylvania and Virginia are reduced under its 3-year term commitment; however, AT&T's $900 special access NRC (applied under both price caps and Price-Flex) in Texas, as compared to the $76 UNE NRC, continues to apply for its 1-year term commitment but is waived if a customer commits to a 3-year term.

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recently reduced its Price-Flex rates to the level of its price caps in Georgia, as well as in other merger-related states not surveyed.

44 Attachment 2 , *Comparison Of UNE DS1 Loop And Special Access* Rates (for all states).

45 Attachment 2, *Comparison Of UNE DS1 Loop And Special Access Rates, For AT&T in Texas, For Verizon in Virginia, & For Verizon in Pennsylvania.*

Qwest's special access NRCs in Arizona and Colorado are 75-85% higher than the UNE NRCs and apply even when a customer commits to a 3-year term.[46]

Rate comparisons for DS1 dedicated transport UNEs and special access channel mileage show similar, if not more extreme, disparities between UNE rates and both price caps and Phase II pricing flexibility rates for special access. At the outset, special access rates for channel mileage and UNE rates for DS1 transport include at least two rate elements: the fixed monthly rate and the mileage rate which varies according to the length of the circuit. The fixed month-to-month recurring Phase II rates for most of the areas analyzed are over 100% percent higher than for the comparable UNE services, with both price cap rates and Phase II rates over 400% higher than the UNE rates in Illinois.[47] The greatest disparity is in mileage rates, where the special access rates in some instances over 10,000% higher than the comparable UNE rate in the state. For example, in Texas the UNE fixed monthly and mileage rates are $33.76 and $0.1005, respectively; the price cap fixed monthly and mileage rates are $62.00 and $15.50; and the Phase II fixed monthly and mileage rates are $85.00 and $18.00.[48] Importantly, in Texas and all but two other states in the study, the Phase II rates exceed the regulated price cap rates by 15-40%.[49]

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46 Attachment 2 , *Comparison Of UNE DS1 Loop And Special Access Rates, For Qwest in Arizona & For Qwest in Colorado.*

47 Attachment 2, *Comparison Of UNE DS1 Transport And Special Access Rates, For AT&T in Illinois.*

48 Attachment 2, *Comparison Of UNE DS1 Transport And Special Access Rates For AT&T in Texas.*

49 Attachment 2, *Comparison Of UNE DS1 Transport And Special Access Rates,* (for all states). In accordance with the conditions of its merger with BellSouth, AT&T recently reduced its Price-Flex rates to the level of its price caps in Georgia, as well as in other merger-related states not surveyed.

Similar to the loop data, one would expect that, even if the month-to-month transport rates remained somewhat higher, there would be a dramatic reduction in rates when customers commit to longer terms. As with the loop rates, however, even the longer-term transport rates remain supra-competitive and well above the cost-based UNE rates. For RBOCs that offer a 1-year term discount – Verizon does not – the price cap and Phase II fixed rates for transport are 43-292% and 79-350% higher than UNE rates, respectively.[50] The rates for a 3-year term are not dramatically better and are still over 100% percent higher than UNE rates in some states.[51] In several Verizon states, for example, where the fixed recurring monthly rates for its month-to-month and 3-year plan are actually lower than the comparable UNE fixed rate, the excessive mileage charges that are 371-4,462% above cost allow Verizon to recover its costs and still effectively undermine its competitor customers.[52] Here, too, the most glaring differences in rates are for mileage for both 1-year and 3-year terms, which, even with the term commitment, are over 1,000% higher than the comparable UNE rates for many states.[53]

C. Neither Merger Conditions Nor Court Decisions Cure the Evident Market Failure

In 2005, the Commission approved the SBC/AT&T and Verizon/MCI mergers subject to conditions including reducing and freezing special access rates for 30

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50 Attachment 2, *Comparison Of UNE DS1 Transport And Special Access Rates,* (for all states).

51 Attachment 2, *Comparison Of UNE DS1 Transport And Special Access Rates, For Verizon in New York; For Verizon in Pennsylvania; & For Verizon in Virginia.*

52 Attachment 2, *Comparison Of UNE DS1 Transport And Special Access Rates,* (for all states).

53 Attachment 2, *Comparison Of UNE DS1 Transport And Special Access Rates,* (for all states).

months.[54] Additional conditions were imposed as part of the 2006 merger of AT&T with BellSouth. These conditions, while marginally helpful, are not truly beneficial for consumers and competitors. First, these conditions are limited in time. Second, they address competitive harms arising from the mergers and not the basic problem of market power in the special access markets. Rates that were already unjust and unreasonable, which they were, would continue to be unjust and unreasonable. Finally, the conditions are carrier-specific and do not apply to other ILECs.

The collocation triggers devised by the Commission as a basis for special access price deregulation have not proven to be accurate predictors of the advent of price constraining competition. The Commission dismissively justified its decision to adopt collocation triggers by citing to the D.C. Circuit Court of Appeals' affirmation of its rationale in its *Pricing Flexibility Order*.[55] But the fact that the court found the adoption of collocation triggers to be a reasonable approach does not mean that it was the right approach or that retaining it remains justifiable. "[A]s the courts have stressed, where, as here, the Commission has based its existing regulatory regime on a predictive judgment, it is absolutely imperative that "the Commission . . . vigilantly monitor the consequences of its rate regulation rules."[56] Rather than blithely ignoring the impact of its pricing flexibility regime, the Commission must review the clear data and analyses presented in

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54 *SBC Communications Inc. and AT&T Corporation Applications for Approval of Transfer of Control*, Memorandum Opinion and Order, WC Docket No. 05-65 (rel. Nov. 17, 2005); *Verizon Communications Inc. and MCI, Inc. Applications for Approval of Transfer of Control*, Memorandum Opinion and Order, WC Docket No. 05-75 (rel. Nov. 17, 2005).

55 Letter from Kevin J. Martin, Chairman of Federal Communications Commission, to The Honorable Joseph I. Lieberman, Chairman, Committee on Homeland Security and Governmental Affairs, at 2 (Jan. 29, 2007).

56 AT&T Petition for Rulemaking at 6 (citing American Civil Liberties Union v. FCC, 823 F.2d 1554, 1565 (D.C. Cir. 1987)).